

EU's Multiannual Financial Framework and some implications for CESEE countries

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based on a joint work with Guntram B. Wolff

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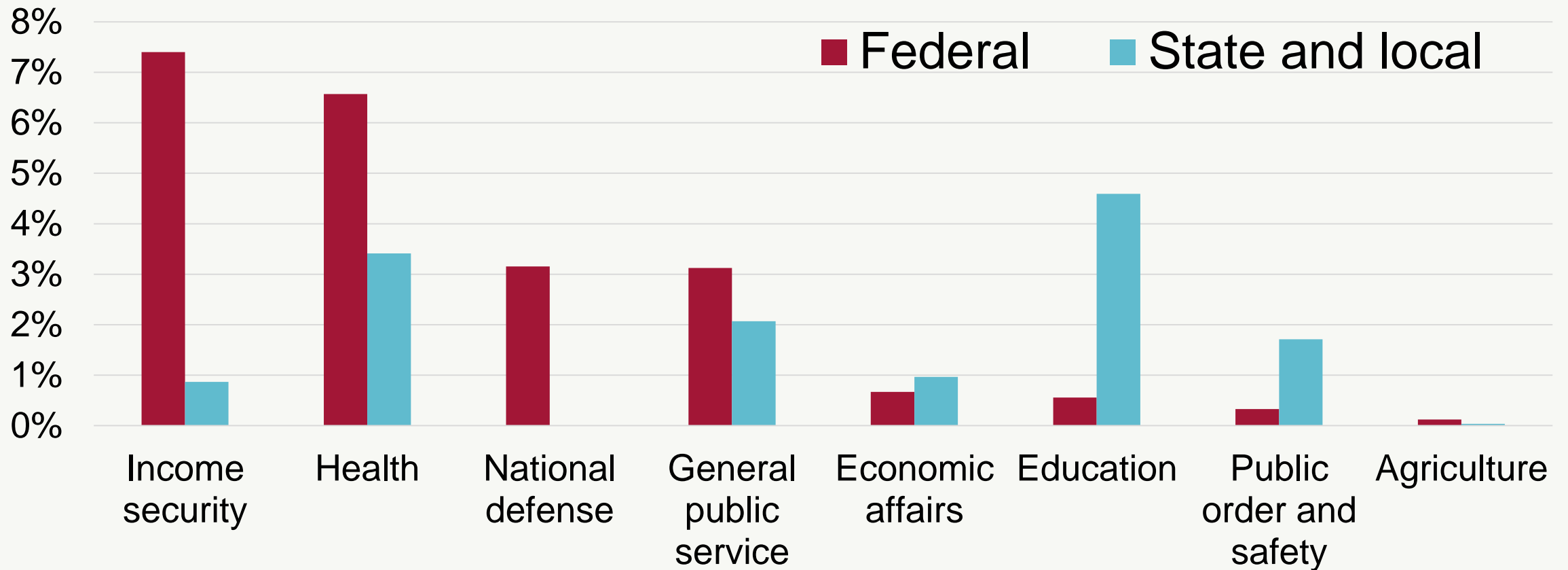
Outline

1. Background: fiscal federations vs EU spending
2. The current EU budget
 - Structure
 - Effectiveness of agricultural and cohesion policies
3. The new MFF
 - Fundamental rethink of EU spending
 - Impact of Brexit

1. Background

- In the United States and other federations, federal spending did not develop at the expense of state spending but rather grew in 20th century as government took on new functions.
- EU is union of well developed nation states, it is not a state nor federation. Essential government functions are difficult to move.
- How should the EU budget best complement what countries already do at the national level? Which functions can be delivered more effectively jointly?
- Fiscal stabilisation function in the EU is national. Re-insurance models can be considered for Euro Area as part of EU budget.

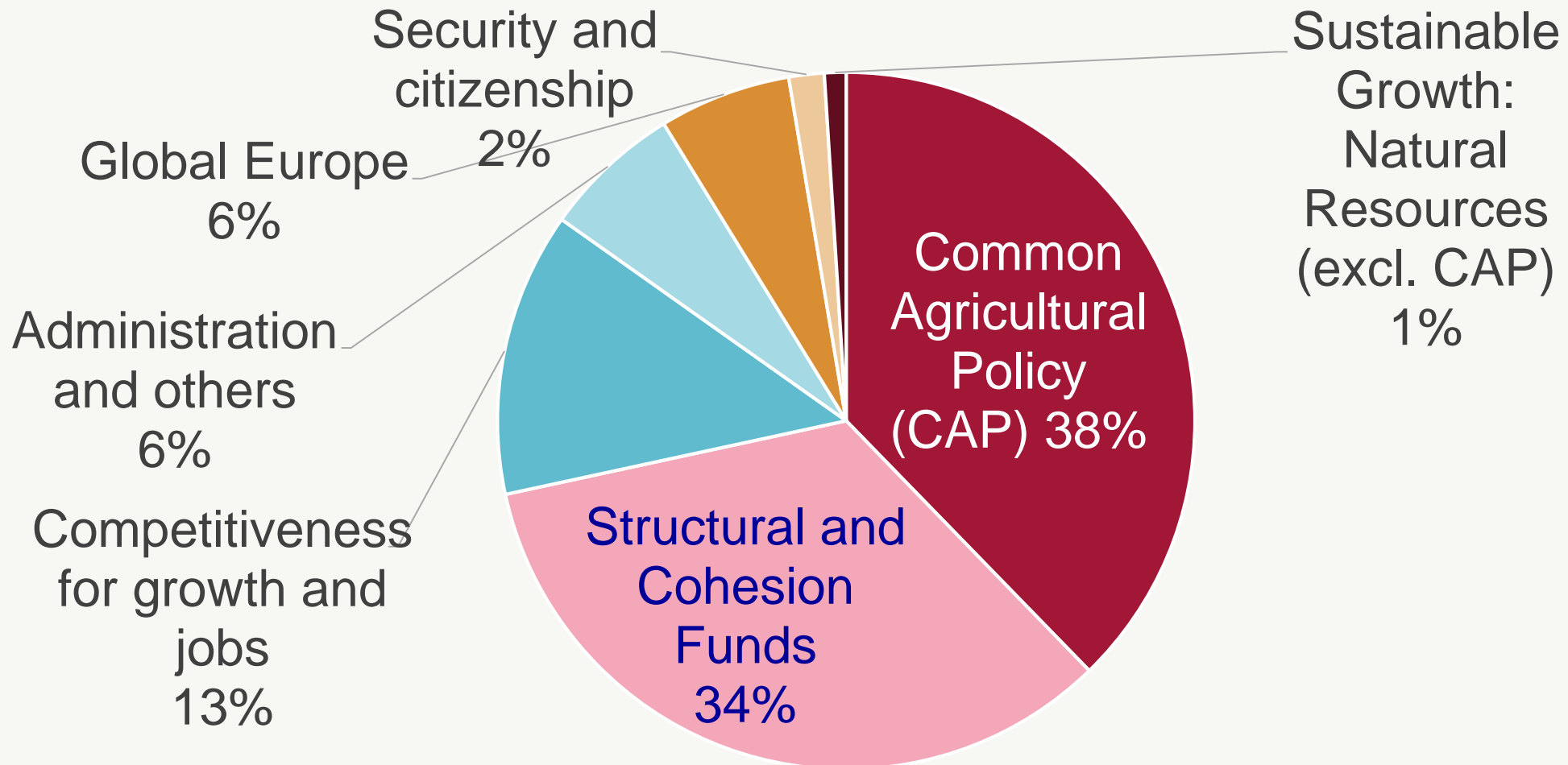
US Budget Structure, 2016, % GDP



Source: Bureau of Economic Analysis

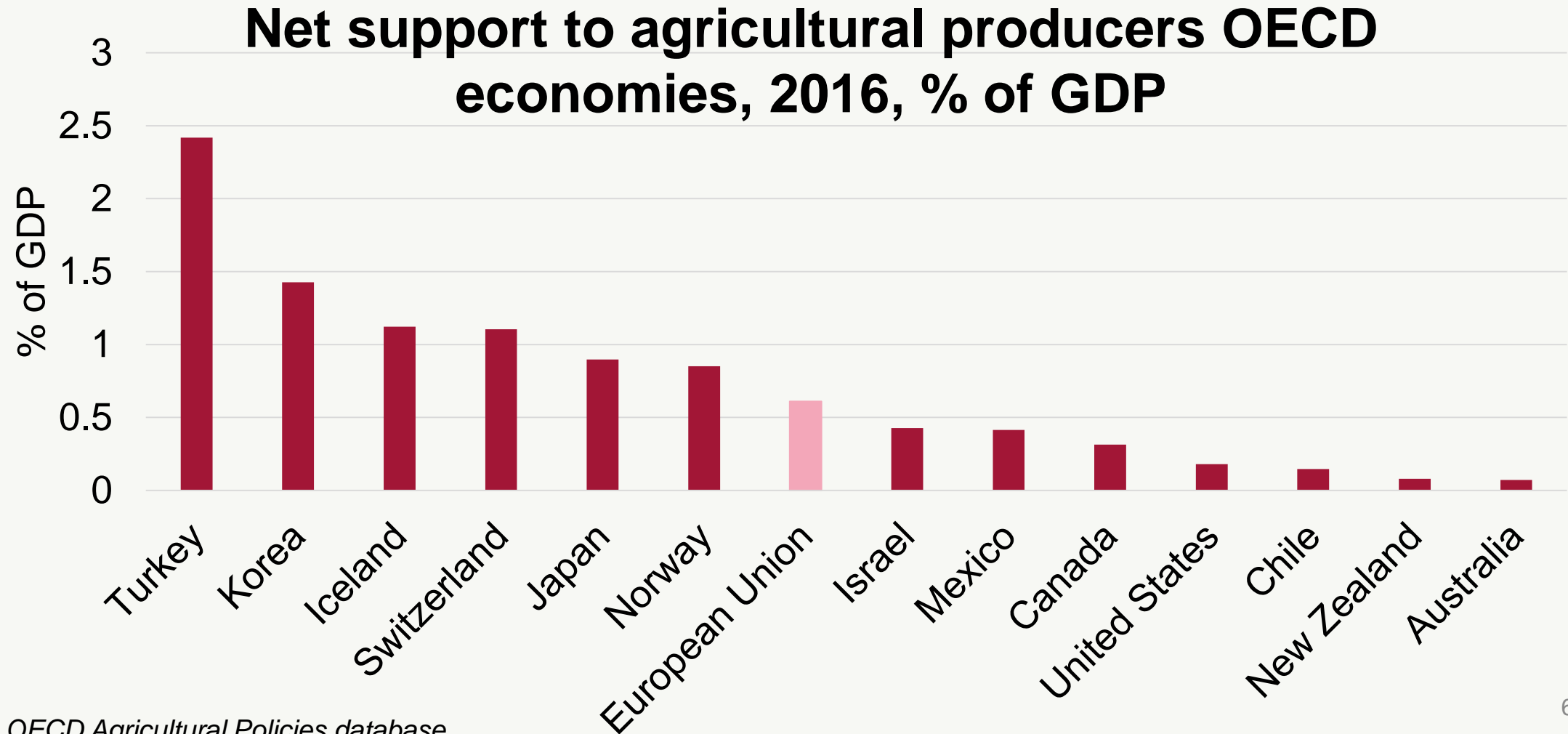
2. The current EU budget

The distribution of the 2014-2020 MFF ceilings



Source:
European
Commission,
Bruegel.

Total EU spending on agriculture is about average in OECD (as % GDP)



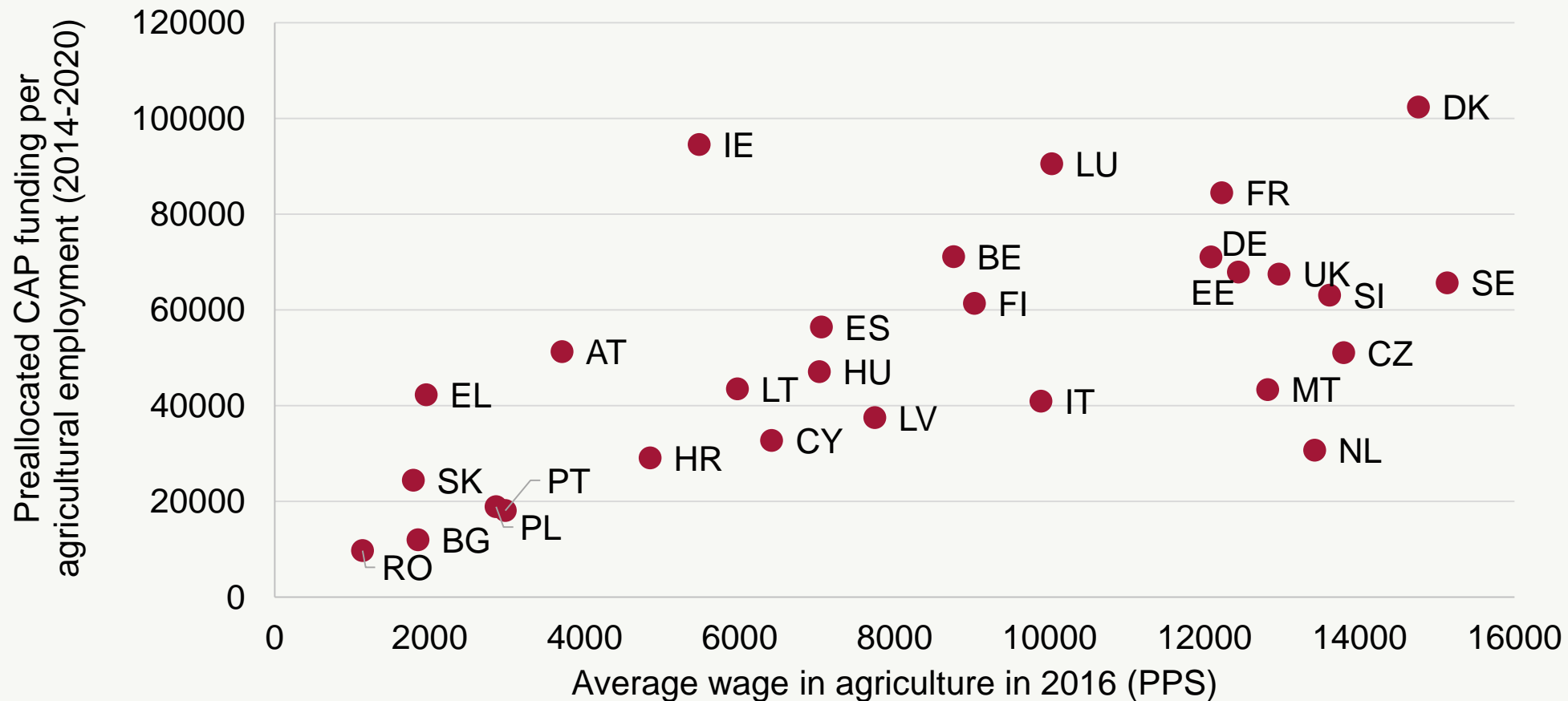
Source: OECD Agricultural Policies database.

CAP should change

- CAP is basically an income support scheme for farmers. But even there unequal: 80% of spending goes to 20% of farmers; and richer countries get more (see next slide)
- There is no reason why income support should be done through EU budget. If social problem, use national social programmes and ESF
- European Court of Auditors (2017): CAP has not achieved its goals in terms of greening and biodiversity
- Alliance Environnement (2017): inefficiencies in managing environmental impacts
- Pe'er et al. (2014): environmental prescriptions are so diluted they are unlikely to benefit biodiversity
- Re-nationalisation or at least national co-financing of income support?

Richer countries get more CAP funding

Relation between CAP funding and wages in agriculture



Source: Bruegel calculation using Eurostat data

Cohesion policy should change

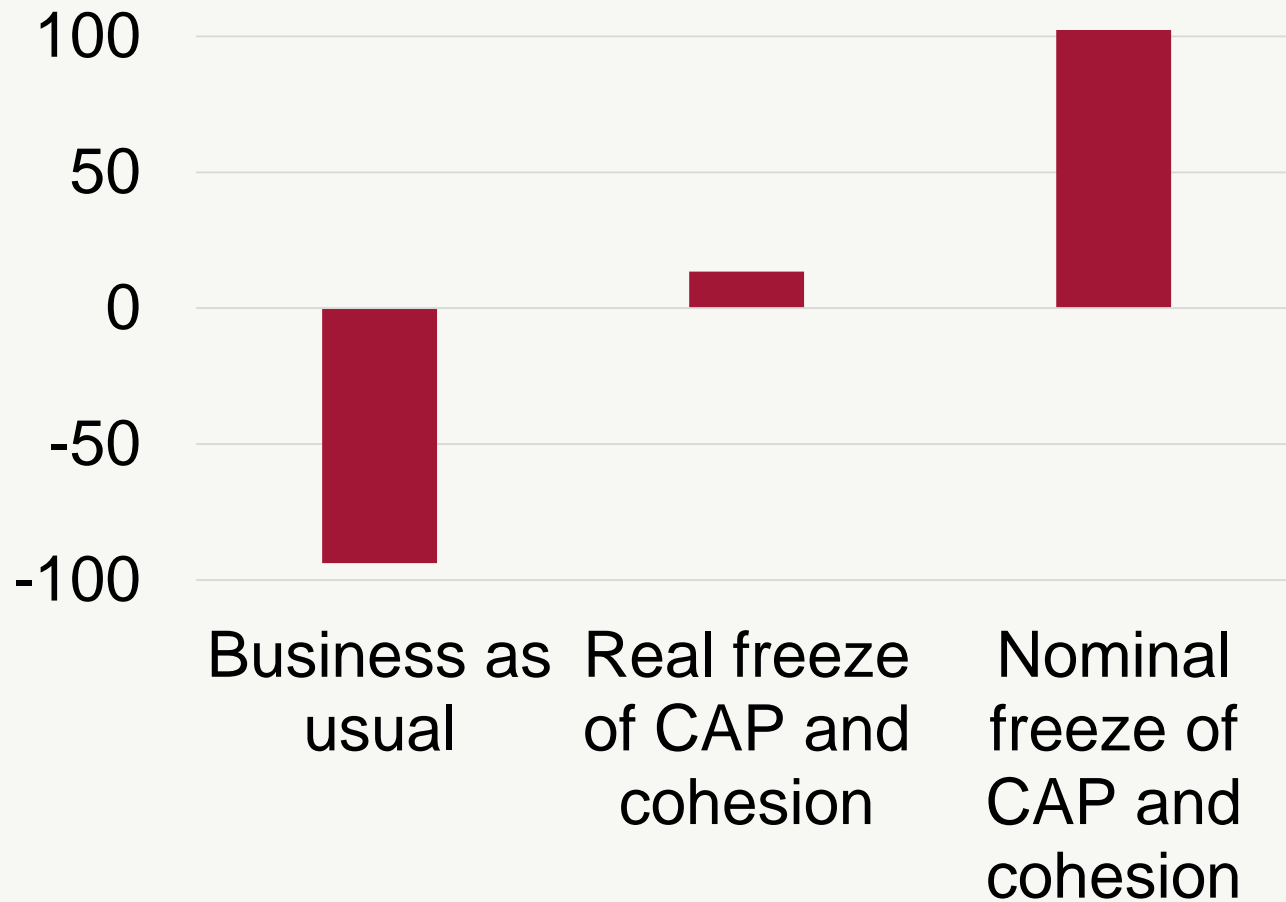
- Macro-model simulations: positive impact by definition
- Empirical studies: mixed (surveys of Marzinotto (2012) and Pienkowski and Berkowitz (2015))
- Pinho et al. (2015) and Fratesi and Perucca (2014): rather negative results
- Pellegrini et al. (2013) and Crescenzi and Giua (2017): positive growth impact of EU regional policy
- Becker et al. (2017) conclude that regional policy has a positive, but short-lived effect on growth
- There is a European rationale for cohesion policy, but needs better design, targeting, control and limiting corruption

3. The future EU budget

- 1st priority: assess which spending areas constitute European public goods and how best to provide these goods
 - *functions with clear pan-European implications: border protection, defense, security, migration, climate policy, pan-European projects in research, mega projects like the EU's satellite program*
- 2nd priority: increase the efficiency and effectiveness of current programs (in particular, CAP and Cohesion Policy)
- 3rd priority: whether there is a need for a specific euro area fiscal stabilization instrument, and if so, within or outside the EU budget

The Brexit hole in the EU budget

(If no UK contribution to next MFF and no EU spending in the UK)



- 1st column: if spending in EU27 and revenues from EU27 grow with GNI: financing gap of €94 billion in 2021-2027
- 3rd column: If CAP and cohesion spending is fixed nominally at current 2014-2020 MFF level, while everything else increases with GNI: €102 billion surplus available for spending on other priorities

Source: Darvas and Wolff (2018)

Possible UK contributions to the next MFF

- Yet UK might contribute to the next MFF due to:
 1. "EU exit fee" (around €17 billion in net terms in 2021-2027)
 2. Contribution for some form of access to EU markets, like Norway (in which case the UK would contribute by €31 billion) or Switzerland (in which case the UK would contribute by €3 billion)

The 2021-27 MFF proposal of the European Commission: “glass half full”

- Some positives:
 - stronger focus on European public goods (huge increases in border control and defense spending; significant increases in research/innovation/digital spending; some increases in migration spending)
 - new rule of law procedure
 - reform of budget revenues
 - leaving broadly unchanged (in nominal terms) CAP & Cohesion (4% cut to CAP, 6% increase in Cohesion)

The 2021-27 MFF proposal of the European Commission: “glass half full”

- Some deficiencies:
 - structure and transparency of the budget
 - lack of co-financing of direct farmer transfers (CAP Pillar 1)
 - larger cut to CAP rural development (Pillar 2) than CAP direct transfers (Pillar 1)
 - timid external action
 - the proposed tools for euro area stabilization and euro adoption are conceptually weak

Conclusions

- The EU budget is, and will remain, far from what public finance theory or experience of fiscal federations suggest
- Key direction of spending reform should be to focus on true European public goods that are more efficiently provided jointly than by the member countries separately
- Two largest EU spending items, CAP & cohesion: question marks about their effectiveness
- Brexit will leave a hole, but nominal freeze of CAP & Cohesion more than compensates and provides resources for new priorities
- Commission's new MFF proposal: good basis for negotiations, but has several weaknesses